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December 23, 1999

Mary L. Cottrell, Secretary
Massachusetts Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02114

Re: Bell Atlantic-MA Fifth Annual Price Cap Compliance Filing, D.T.E. 99-102

Dear Ms. Cottrell:

Pursuant to the public notice issued by the Department of Telecommunications and Energy ("Department") on December 6, 1999, the Attorney General submits this letter as his initial comments on Bell Atlantic-Massachusetts' ("Bell Atlantic" or "the Company") Fifth Annual Price Cap Compliance Filing ("Filing"). The Attorney General has completed a preliminary review of the Filing and based upon that review, as discussed below, urges the Department to:

- reject summarily Bell Atlantic's attempt to deny its customers \$21 million of the \$48 million rate reduction that they would receive absent the Company's new, flawed suggestion that the productivity factor used in its price caps formula should be reduced from 4.1 percent to 2.94 percent;
- conduct further proceedings to determine the lawfulness of Bell Atlantic's proposal to maintain Touch-Tone monthly service charges for residential customers but eliminate Touch-Tone monthly service charges for business customers; and
- require Bell Atlantic to put into effect, without any suspension pending the Department's inquiry, the full revenue reduction required under the plan (i.e., using a 4.1 percent productivity factor).

The comments contained in this letter do not address all issues raised by the Filing; accordingly, the lack of comment on other matters contained in the filing should not be construed in any way as the agreement, assent, or acquiescence of the Attorney General.

1. The Department should reject Bell Atlantic's productivity factor proposal.

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The Department should reject Bell Atlantic's proposal to reduce the productivity factor from 4.1 percent to 2.94 percent. Not only is this proposal inconsistent with the plain intent of the Price Cap Plan ("Plan") adopted in NYNEX, D.P.U. 94-50 (1995) ("D.P.U. 94-50"), but it flies in the face of the actual past implementation of that Plan. The Company is suggesting that it be allowed to erase the fact that its poor service quality performance in 1995 and 1996 resulted in lower revenues in the following years. The net effect of the Company's proposal is to reduce -- by \$21 million -- the benefits its customers otherwise would enjoy under the price cap adopted by the Department in 1995. The Department should reject the Company's proposal.

In D.P.U. 94-50, the Department adopted a "price cap" approach for the regulation of the Company's monopoly service rates. In annual filings, the Company is required to adjust its rates so that its revenues increase or decrease by an amount by which the rate of inflation is less than the amount of a 4.1 percent productivity "offset" intended to reflect anticipated productivity gains in the industry as well as "accumulated inefficiencies." In D.P.U. 94-50, the Department also required an increase in the productivity offset equal to one-twelfth of one percent for each month (in any given year) that Bell Atlantic failed to achieve either: (1) an overall service quality performance threshold, or (2) the required level for at least ten of the twelve individual service items that comprise the service quality index. D.P.U. 94-50 at 237-8. As the Department explained, "the Company should have a financial incentive to achieve" the prescribed level of service quality. *Id.* at 238. Importantly, the Department specifically stated that "[a]ny resulting increase to the productivity offset shall not carry over to any future annual filings." D.P.U. 94-50, at 237, n. 137 (emphasis supplied).

In its November 17, 1999, filing, Bell Atlantic proposes that it be allowed to reduce by more than 25 percent the 4.1 percent productivity offset established in the Department's 1996 decision (a reduction to 2.94 percent). In its filing, the Company did not attempt to justify this proposal other than to suggest that it is somehow appropriate because it "continues to meet or exceed all Service Quality criteria ..." Filing, Section A, Tab 2, p. 2. It describes its proposal as "a reversal of the service quality penalty increases that were implemented in the Price Cap Filings of July 3, 1995 and June 10, 1996 (.83 and .33 respectively)," and it offers the following as a statement of the problem that its proposal is intended to address:

The Annual Price Regulation filings of July 3, 1995 and June 10, 1996 contained increases in the productivity offset associated with the Company's failure to meet the 33-point threshold for overall performance. In both instances, the Company neglected to reverse those increases to the productivity index in its subsequent annual filings. As a result, the increases to the productivity offset associated with service performance were carried over to subsequent annual filings contrary to the terms of the Plan.

Id. (emphasis supplied).

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The Department should reject Bell Atlantic's request to lower the productivity factor. The Company is misinterpreting the language in the Department's earlier order. Footnote 137 specifically provides that any service quality related "increase to the productivity offset shall not carry over to any future annual filings." Indeed, review of the record indicates that the 1995 and 1996 increases in the productivity offset were not carried over to future annual filings: 4.1 percent was the productivity offset used in each year. (1)

In essence, Bell Atlantic is attempting to misapply the Department's proscription against carrying over service quality adjustment to the productivity offset in order to adjust the price regulation index ("PRI"). This result is simply not supported by the Department's earlier decision. The only logical interpretation of the D.P.U. 94-50 language is that it required that the productivity factor revert to 4.1 every year, subject to a further increase for another failure to meet the service quality standards. The Company's new reading of the Plan not only would require that any increase in the productivity offset not be carried over into the next year, but also would require that the subsequent year's productivity offset be reduced by the amount of any service quality increase in the preceding year. Plainly, such an interpretation is without merit. Cf. Boston Gas Company, D.P.U. 98-98 (1999) (applying the price cap formula to a preceding year's revenue level without adjustment for a past service quality penalty).

In essence, Bell Atlantic is seeking to revise the Regulation Price Index to the value it would have had had the service quality penalties not been assessed. If the Department allows this proposal, it will have modified the Plan adopted earlier to provide a sizable reward for belatedly achieving (after first failing to meet) the service quality standards set forth in D.P.U. 94-50.

2. Bell Atlantic's Touch-Tone reduction is price discrimination and anti-competitive and must be investigated.

Bell Atlantic has proposed to eliminate the current monthly rates for Touch-Tone service collected from its business customers but to maintain the current rates for residential customers. While substantial, the pricing flexibility granted to Bell Atlantic is not unlimited. Indeed, the Company's proposal for unfair and disparate treatment of different customer classes in regard to Touch-Tone service may amount to undue discrimination and anti-competitive pricing. The Department should investigate further the proposed disparate treatment of business and residential customers in regard to the provision of the same service and determine whether that treatment is "justified by the cost of the respective services by their values, or by other conditions." Hull Municipal Light Plan, D.P.U. 87-19-A, p 42 (1990), aff'd sub nom. Bertone v. Department of Public Utilities, 411 Mass. 536 (1992). The Department has the authority to investigate the proposed tariff revision and should determine whether the proposal amounts to price discrimination, whether this pricing is part of an anti-competitive strategy, and/or whether it creates a cross-subsidy. G.L. c. 159, §§ 19 and 20. NYNEX, D.P.U. 95-83, at 13-14 (1995).

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3. Effective date of rate changes.

The Department has asked for comments on whether the proposed rate changes should be suspended during the Department's investigation of the filing. The revisions to M.D.T.E. Tariff No. 10 will take effect on January 17, 2000, unless suspended by the Department. In previous price cap compliance filings, the Department has ordered that the rates should not be suspended. The Attorney General recommends that the Department require Bell Atlantic to put into effect on January 17, 2000, the full rate reduction using the 4.1 percent productivity factor that is required under the Plan adopted in D.P.U. 94-50, and order Bell Atlantic to submit to the Department within ten calendar days an amended Filing reflecting the full 4.1 percent productivity factor. Suspension of the rate reductions would prevent Massachusetts consumers from receiving the benefits of these price reductions until the end of the statutory suspension period. Suspension would further unfairly benefit Bell Atlantic by allowing Bell Atlantic to keep the revenues associated with the delay.

Sincerely,

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cc: Attached service list

1. It should be emphasized that although the 4.1 percent productivity offset was increased by 0.33 in 1996 as a result of the Company's failure to achieve the required level of service quality performance, the 0.83 increase from 1995 was not carried over: the resulting offset was 4.43 percent, not the 5.26 percent it would have been had the 1995 increase been carried over. The offset used in 1997 and 1998 was 4.1 percent.

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